Section 716 – Push Out Rule

The provision requires covered U.S. banks to Push-out certain derivatives transactions into a separately capitalized non-bank affiliate

➢Equity, Commodity, and Credit Derivatives will be forced into the non-bank affiliate

➢FX, Rates and cleared investment grade Credit Derivatives will be permitted to stay within the Bank

➢This will bifurcate derivatives transactions for end-users and other clients that seek a diverse range of products to manage their risk

➢Derivative transactions are governed by ISDA legal agreements, wherein currently clients transact derivatives in all products, under one master ISDA agreement with the Bank

Pushing-out Equity/Commodity/Credit derivatives to non-bank entities, and leaving FX/Rates derivatives on the Bank, will break this netting, and result in higher counterparty risk, greater costs for clients, and the inefficiencies will tie up capital that could otherwise be used for hiring or expansion.

Example of Impact on Clients – 2

Large Mining Corporation:

Large mining corporation transacts both FX Derivatives and Commodity Derivatives with the Bank under one ISDA legal agreement. Netting benefits provided by the current single Bank entity will be lost when Commodity Derivatives are Pushed-out to a separate Non-Bank entity.

The mining corporation currently has the following exposures with the Bank as of 9/30/11:

- Bank is owed $0.3mil by the mining corporation for Mark to Market on diesel fuel hedging trades
- Bank owes the same mining corporation $13.88mil for Mark to Market on FX transactions

Under one common ISDA with the Bank, credit exposure, and margining, is netted. **Post implementation of Push-out, where Commodity Derivatives will be forced to transact from a non-bank entity, both firms will have exposures.**

➢**As the client loses netting, it is likely they will migrate all derivatives to a firm not impacted by the Push-out provision or they will have higher costs for their transactions and the inefficiencies will tie up much needed capital.**

The Push Out Rule

- **The Push-out rule increases risk management costs for end-users, reduces competitiveness of US Banks, and could increase systemic risk because it works against the resolution authority parts of Dodd Frank**
  - Direct and indirect costs to clients and end-users
  - Unlevel playing field causes loss of competitiveness, versus international banks
  - Massive legal entity restructuring may increase systemic risk because objectives of resolution authority provisions is to concentrate transactions in one bank entity NOT spread them throughout the firm
  - Loss of clients, revenues & diversification impedes the safety and soundness of financial institutions

- **In the absence of modification, harmful effects can be reduced through thoughtful implementation and interpretation**
  - **Sequencing is important**
    - If clearing solutions are more fully developed in the market, impact on clients and institutions of restructuring and will decrease
    - Implementation date should be 3 years after mandatory clearing is implemented by CFTC/SEC
  - **The regulators need to study the impact before implementing the Push-out**
    - As with many other Dodd-Frank provisions, implementation should be studied to develop a more thoughtful approach and minimize negative effects
  - **Regulators need to provide clarity on international application**
    - Provision does not apply to foreign banks (since most book their global derivatives, including to US clients, from a European entity), and no foreign regulators are proposing similar provision
    - Push out should not be applicable to foreign branches or subsidiaries of US banks, as those entities compete directly with the foreign banks that are not subject to this rule